

July 22, 2005

Mary L. Cottrell, Secretary
Department of Telecommunications and Energy
One South Station, 2nd Floor
Boston, Massachusetts 02110

RE: Default Service, D.T.E. 04-115

Dear Secretary Cottrell:

On June 20, 2005, the Department of Telecommunications and Energy ("Department") held a technical conference to further discuss (1) the "laddered" resource portfolio approach; (2) renewable resources; and (3) the expansion of customer choice for smaller customers. As a follow-up to the technical conference, the Department requested additional written comments. The Attorney General submits this letter as his comments on the issues discussed at the technical conference.

I. SUMMARY OF THE ATTORNEY GENERAL'S POSITION

As the Department has investigated the pricing and procurement of default/basic service, the Attorney General has consistently recommended that (1) default/basic service for small customers be procured and priced over a longer term in order to assure greater price stability for those customers; (2) retail choice should be maintained and therefore customers should not be involuntarily assigned to retail suppliers (i.e., slammed); (3) any changes to default/basic service should produce real benefits for all customers, and all proposals for change must be measured against this standard. *See* Attorney General's Comments, D.T.E. 02-40 (2002); Attorney General's Comments, D.T.E. 04-115, (January 10, 2005).

While the Attorney General supports the Department's efforts to facilitate the development of a competitive market for smaller customers, that effort should be based on maximizing consumer welfare by minimizing long-term costs to consumers while maintaining a safe and reliable default/basic service. The results of the residential customer survey that the Attorney General submitted to the Department on June 16, 2005, indicate that a majority of customers are not well informed about electric restructuring. In addition to the lack of customer

education, the wholesale electric market continues to experience major uncertainties stemming from federal regulatory measures.

Standard offer only ended approximately four months ago. That is not enough time to determine whether the competitive market for smaller customers needs assistance to develop. The Department should avoid proposals where the price of default/basic service does not reflect the actual cost of power in the market or that confuse customers. Instead, it should focus on proposals that (1) mitigate the volatility that is currently in the price of default/basic service and strengthen the bilateral capacity market (e.g., through longer term contracts) and (2) educate smaller customers about purchasing electricity from competitive suppliers.

II. INTRODUCTION

The General Court has determined that “electricity service is essential to the health and well-being of all residents of the commonwealth, to public safety, and to orderly and sustainable economic development,” and that “affordable electric service should be available to all consumers on reasonable terms and conditions.” *Electric Utility Restructuring Act of 1997* (“Act”) St. 1997, c. 164, §1. The Legislature recognized that the transition from a monopoly-regulated electricity market to a competitive market structure would take time and would require a service of last resort or default service for those customers who, for whatever reason, were unable to secure standard offer service or competitive service in the restructured market. The Legislature’s intent was that service of last resort, or default service, was the means of ensuring that all customers in Massachusetts have universal access to electricity.¹

The Department opened a number of investigations to ensure that the manner in which default service is provided is compatible with the development of an efficient competitive market so that the benefits of a competitive market were available to all Massachusetts consumers at the end of the standard offer transition period. *See Pricing and Procurement of Default Service*, D.T.E. 99-60 (1999); *Metering and Billing*, D.T.E. 01-28 (2001); *Competitive Market Initiatives*, D.T.E. 01-54 (2001); *Provision of Default Service*, D.T.E. 02-40 (2002).² Nothing produced in this docket has cast doubt on the Department’s prior conclusion that

¹ General Laws Chapter 164, Section 1B(d) requires that “the department shall ensure universal service for all ratepayers”

² Currently, distribution companies procure 50 percent of their default service supply for residential and small C&I customers semi-annually through competitive solicitations for twelve-month terms, with the default service rate set for six months. *See* D.T.E. 02-40-B. The Department approved this procurement strategy to strike a balance between providing sufficient price certainty and efficient price signals. *Id.*, p. 44.

For smaller customers, it must be recognized that the distribution companies' provision of default service in the manner directed in this order may be the most efficient market structure.

D.T.E 02-40-B, p. 32.³

During the review and possible modification of its default/basic service policies, it is important for the Department to carry out the Legislature's intent "that electric service will be available at a reasonable price, consistent with each person's need to access electricity to function in modern society. . . ." D.T.E. 02-40-B, p. 7; see *Electric Utility Restructuring Act of 1997* ("Act") St. 1997, c. 164, §1.

III. THE DEPARTMENT SHOULD SEEK TO MITIGATE VOLATILITY IN THE DEFAULT/BASIC SERVICE PRICE

As of May 2005, approximately 93 percent of residential electricity consumption and 87 percent of small C&I electricity consumption is provided through default service.⁴ Basic Service is now, in all likelihood, the primary service for the majority of customers, and thus Department should assure that any modifications in the default/basic service procurement and pricing policies will benefit customers.⁵

The Department should implement measures that create stable and equitable pricing for default/basic service. Default/basic service should be the "benchmark" against which competitive offerings can be compared and should also be a safety net for customers. Default/basic service should be priced to reflect equitable prices based on balanced and diversified portfolios. Proposals for a default/basic service that is volatile, or reflects short-term wholesale market conditions, in order to spur customers to migrate to alternative providers create a potential for hardship for customers who may have no alternatives.

Longer-term contracts of up to two to three years would reduce volatility in basic service. Smaller customers would benefit from power contracts procured with terms longer than twelve months because of: (1) the reduced variability of the portfolio price; (2) the possibility of a lower price for default service to support the bilateral capacity market; and (3) a greater diversity of

³ Customers on default/basic service have also benefitted from competition through utility procurement of power from the competitive wholesale market.

⁴ These percentages were derived from the May 2005 customer migration statistics found at the Division of Energy Resources' website at http://www.mass.gov/doer/pub_info/0505.xls

⁵ "[T]he function of the department is the protection of public interests and not the promotion of private interests." *Lowell Gas Light Company v. Department of Public Utilities*, 319 Mass. 46, 52, (1946). See *Massachusetts Institute of Technology v. Department of Public Utilities*, 425 Mass. 856, 873, fn. 38 (1997).

supply. In Maine, Ohio and Pennsylvania, for example, the default service prices are known for two to three years which allows retailers to offer longer term fixed prices. Tr., p. 249; *Order Designating Standard Offer Provider and Directing Utility To Enter Entitlements Agreement*, Maine P.U.C. Docket Nos. 2004-682 and 2004-589 (2004).

Mitigating volatility in default/basic service prices would also protect smaller customers from continuing uncertainties in the wholesale market. The wholesale market, upon which retail electric service depends, continues to experience major structural changes that ultimately affect the procurement and price of default/basic service. Since the enactment of the 1997 Restructuring Act, the Federal Energy Regulatory Commission (“FERC”) has undertaken a series of steps to change the wholesale electric markets, including the implementation of locational marginal pricing, designed to send more accurate price signals to constrained areas on the transmission system; the elimination of “seams” issues through Standard Market Design; and the creation of day ahead markets, forward reserves markets, and the currently proposed LICAP “market” and pending changes to other “markets.”⁶ Each of these FERC changes to the wholesale markets has an effect on retail markets and on default service procurement and pricing.⁷ For example, the LICAP market alone, if implemented as scheduled in 2006, would increase costs to consumers in New England in excess of \$13 billion during the first 5 years of operation.⁸ Until the wholesale market rules have been in place and have a proven track record of predictable results, the Department should seek to mitigate the volatility in the current pricing and procurement design of default service through longer term contracts.⁹

⁶ In its Standard Market Design Notice of Proposed Rule making (“NOPR”), FERC clearly and unequivocally stated that the transition to competitive electricity markets has not fulfilled the promise to provide more customer choice and lower average electric rates. FERC noted that the California electricity crisis, the collapse of Enron, the allegations of improper trading practices, and the financial deterioration of many energy suppliers and marketers has “added unprecedented uncertainty about, and lack of confidence in, today’s electric markets.” *Remedying Undue Discrimination through Open Access Transmission Service and Standard Electricity Market Design*, 100 FERC ¶61, 138, 2002 WL 31998476 (F.E.R.C.), p. 24 (July 31, 2002). FERC has been making changes in the wholesale market in an attempt to remedy this situation.

⁷ Uncertainty regarding proposed LICAP market rules, regions and the shape of the demand curve will create challenges for participants in default/basic service procurement solicitations. *Devon Power LLC, et al.*, Order on Compliance Rehearing and Clarification, 109 FERC ¶61,154, 2004 WL 2505387 (F.E.R.C.), p. 10 (November 8, 2004).

⁸ According to testimony filed with FERC, the ISO’s proposal would result in the Boston/Northeast Massachusetts market area customers paying almost 3 cents /kWh more in 2010. *Devon Power LLC, et al.*, 107 FERC ¶61,240, 2004 WL 1211567 (F.E.R.C.) (June 2, 2004), Exhibit Mass AG-1.

⁹ Significant questions have been raised in the LICAP proceedings about the creation of LICAP zones and the impact this may have on market power, in addition to concerns raised about the cost and effectiveness of the ISO-NE LICAP proposal. *See Devon Power LLC, et al.*, 107 FERC ¶61,240, 2004

IV. THE DEPARTMENT SHOULD CONSIDER ONLY THOSE CHANGES TO DEFAULT/BASIC SERVICE POLICIES THAT HAVE CLEAR BENEFITS FOR CUSTOMERS

The Department should require proponents of changes in default/basic service programs to demonstrate affirmatively that customers will benefit from the proposals and not be worse off than they were before the changes took place. As the Department determined in D.T.E. 02-40-B, the need for stable, equitable electricity rates, particularly for residential and small commercial customers, and programs and policies that assure that vulnerable and low-income consumers can maintain essential electricity service outweighs the notion of competition for competition's sake.

Competition is the means to an end -- that end being maximizing consumer welfare. Maximizing consumer welfare means minimizing long-term costs to consumers while maintaining the safety and reliability of electric service. If consumer welfare is maximized with very few customers switching to competitive suppliers, it is not a policy failure, as long as there is free choice and there are no artificial impediments for either suppliers or consumers.

D.T.E. 02-40-B, p. 6.

National Grid has proposed a pilot program¹⁰ that it believes will increase competition for small customers. Implementing that pilot program may be premature, however, without giving small customers more education about electric restructuring and competition in electric markets. The Orange and Rockland program in New York on which National Grid's proposal is modeled has not performed as well as anticipated. Although the customer migration was apparently high during the four years the program has been in place,¹¹ no data has been provided to compare the benefits customers received during the introductory discount period with the savings, or increased prices, experienced by customers who continue service with the supplier. Comments of NYSEG and RG&E On the Orange and Rockland Utilities, Inc. Retail Access Plan, NY P.S.C.-08-05-00008-P, p. 3 (March 23, 2005). Many customer advocates and New York utilities believe the New York program does not benefit customers and does not necessarily result in customer

WL 1211567 (F.E.R.C.) (June 2, 2004). Default/basic service should be designed in such a way that it does not exacerbate market power or unnecessarily increase customer costs.

¹⁰ National Grid has filed a similar proposal with the New York Public Service Commission that has not yet been approved. Comments of National Grid, p. 3 (June 20, 2005). It includes a "Power Switch" style program for smaller customers and the purchase of supplier receivables. *Id.* This program would have several suppliers providing an initial percent discount for two months to Massachusetts Electric basic service price for residential and G-1 customers who opt in then the supplier would directly contract with the customer for service beyond the initial two months. *Id.*, p. 4.

¹¹ The Orange and Rockland program supposedly achieved 30% residential migration. Comments of National Grid, p. 4 (June 20, 2005).

savings. *See* Supplemental Comments of NYSEG and RG&E On the Orange and Rockland Utilities, Inc. Retail Access Plan, NY P.S.C.-08-05-00008-P, p. 6 (April 11, 2005); Public Utility Law Project of New York, Inc. Petition For Rehearing and Clarification of Order Adopting Three Year Rate Plan, NY P.S.C. Case 04-E-0572 (April 25, 2005). Similarly, National Grid's proposed program for Massachusetts neither guarantees an appropriate level of customer savings nor describes any clear customer benefits.

The Department should scrutinize such proposals carefully, and not approve pilots which do not provide sufficient customer education or promise benefits that fail to materialize.¹² As the Department has previously recognized, such a result "could undermine restructuring efforts and reduce the anticipated benefits of an improved industry structure." *Electric Industry Restructuring*, D.P.U. 95-30, p. 45 (1995).

In order to increase competition for smaller customers, other states have implemented different methods. Texas was mentioned frequently during the technical conference as a state that has tried to create a competitive market for smaller customers, with differing opinions on the success of the methods. *See* Tr., pp. 42, 195-196, 199, 214, 218. In Texas, the basic service price, the "price to beat," is significantly higher than, and bears no relationship to, the cost of providing that service. This type of price manipulation not only sends out the wrong price signals to customers for consumption, but increases prices for the customer and affords little if any savings to the customer.¹³ The Department has previously rejected the use of adders, stating "that it would be inappropriate to artificially increase default service rates for the purpose of spurring competition." *See* D.T.E. 02-40-B, p. 9 *citing* D.T.E. 99-60-A, p. 11.¹⁴

¹² "The threshold for stimulating shopping behavior among residential customers is relatively high, with nearly eight-in-ten (77%) of these customers only willing to shop and compare electricity suppliers when it yields at least a 10% savings off their **total** monthly electric bill." *Summary Report of Residential Choice Survey 2004*, Critical Insights (2004), p. 34. This 10% discount is comparable in dollar amount to the 6% discount in Texas referred to during the technical conference (Tr., p. 201) because of the greater kilowatthour usage in Texas (1000 kWh typical usage versus the 500 kWh typical usage in Massachusetts).

¹³ One study suggests that electric restructuring in Texas has not yet resulted in lower prices for the majority of residential energy customers in areas open to competition and that residential electricity costs have increased at a greater rate in areas of Texas that offer retail choice than in areas where retail competition has not been introduced (at typical consumption level of 1000kWh per month). *Has Electric Utility Restructuring Led to Lower Electricity Prices For Residential Consumers in Texas?*, J. Zarnikau, D. Whitworth, Elsevier, Ltd., p. 1 (2005).

¹⁴ "While it is critical that all costs of providing default service be included in the retail price to provide an accurate price signal, it is inappropriate to include artificial costs for the purpose of competition. Inclusion of such costs would inflate artificially the default service price and would not be consistent with the General Court's mandate that the price of default service not exceed the average monthly market price of electricity." D.T.E. 99-60-A, p. 11.

V. THE DEPARTMENT SHOULD ENCOURAGE EDUCATION OF CUSTOMERS ABOUT CHOICE IN THE ELECTRIC MARKETS

In D.T.E. 02-40-B, the Department recognized that one reason for the lack of migration of small customers to competitive suppliers was that “customers may not yet be sufficiently informed and educated about their competitive options.” *Id.*, p. 31. The Attorney General submitted a residential customer survey to the Department that supports the observation. According to the results of the survey, nearly three-fourths of respondents (**72%**) indicated that they are either not very well informed or not at all informed about electric restructuring. *Summary Report of Residential Choice Survey 2004*, Critical Insights, p. 13. Only seven percent said that they are very well informed. *Id.* This indicates a need for better consumer education about competition in electric markets.¹⁵ Education of customers so that they can make informed choices should be a Department priority. Many comments made at the technical conference emphasized the need for informed customer choice when developing a competitive market. *See* Tr., pp. 203, 248, 252. Customers are better able to make informed choices when they are properly educated as to their choices.¹⁶

¹⁵ The Department should encourage education programs, such as those conducted by the Associated Industries of Massachusetts.

¹⁶ The Division of Energy Resources has some information on its website (<http://www.mass.gov/doer>) regarding the effect of electric restructuring on power supply options now available to customers, however, more comprehensive education programs should be developed.

VI. CONCLUSION

The Attorney General supports looking at ways to develop competitive markets for smaller customers. Before adopting a change, however, there must be a showing that smaller customers will receive benefits such as savings on their bills or better services from competitive suppliers. Smaller customers need to be better informed about their choices through a comprehensive education program. In addition, more studies should be conducted to determine what smaller customers want in a competitive market. Once it has identified the smaller customers' competitive needs, the Department will have better information to implement necessary changes to default/basic service to establish a competitive market beneficial to smaller customers.

Respectfully submitted,

THOMAS F. REILLY
ATTORNEY GENERAL

By:

Joseph Rogers
Colleen McConnell
Assistant Attorneys General
Utilities Division
Office of the Attorney General
One Ashburton Place
Boston, MA 02108
(617) 727-2200

COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Request for Comments on the Procurement of)
Default Service Power Supply For)
Residential and Small Commercial and)
Industrial Customers)
_____)

D.T.E. 04-115

CERTIFICATE OF SERVICE

I hereby certify that I have this day caused the foregoing document to be served upon each person on the service list compiled by the Secretary. Dated at Boston this 22nd day of July, 2005.

Colleen McConnell
Assistant Attorney General
Office of the Attorney General
Utilities Division
One Ashburton Place
Boston, MA 02108
(617) 727-2200